LIU, J.

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S211645

IN THE SUPREME COURT OF CALIFORNIA

J.R. MARKETING, L.L.C. et al.,
Plaintiffs, Cross-Defendants and Respondents,

v.

HARTFORD CASUALTY INSURANCE COMPANY,
Defendant, Cross-Complainant and Appellant.

AFTER A DECISION BY THE COURT OF APPEAL, FIRST APPELLATE DISTRICT, DIVISION THREE
CASE NO. A133750

REPLY TO ANSWER TO PETITION FOR REVIEW

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INTRODUCTION: WHY REVIEW SHOULD BE GRANTED

This Court should grant the petition for review. It is not only that the Court of Appeal has reached a result that is unjust, because that fact alone would not justify this Court's granting review. It is also that the rule the Court of Appeal has adopted will reverse the course of California law that has developed in the insurance context, and will incentivize attorney conduct that is completely inconsistent with the principles embodied in the Rules of Professional Conduct.

I. REVIEW IS REQUIRED TO CLARIFY THE LAW OF RESTITUTION AS APPLIED TO INSURANCE CARRIERS.

The issue presented by Hartford's petition for review is whether an insurer that has been denied the protections of Civil Code section 2860 (section 2860) and has been required to pay independent counsel's fees and disbursements without any right of review during the pendency of an underlying case may seek reimbursement of unreasonable or unnecessary fees and disbursements only from its insureds, the law firm's clients, or whether it may seek such reimbursement from the law firm itself. This issue goes to the heart of the law of restitution and to the regulation of the legal profession in this state. Its importance is discussed in Section II below.

Buss v. Superior Court (1997) 16 Cal.4th 35 (*Buss*), explained the law relating to reimbursement in detail. Noting that insurers had successfully prosecuted such claims for some years (*id.* at p. 51, fn. 13), *Buss* categorized the cause of action as a species of the even more well-established one for restitution: "Under the law of restitution, a right of this sort runs against the person who benefits from 'unjust enrichment' and in favor of the person who suffers loss thereby" (*id.* at p. 50, citing Rest., Restitution § 1, coms. a, c, & d, pp. 12, 13). This basic principle of California law, if applied, should permit an insurer to sue its insureds' independent counsel for reimbursement in a proper case: When forced to pay large sums for unnecessary or unreasonable legal fees and disbursements, the law

firm unjustly benefits at the expense of the insurer, which suffers loss as a result.

The argument that it was only the insureds and not the law firm that benefitted fails. As the petition for review observed, if the work for which the law firm—in this case, Squire Sanders (US) LLP—collected fees and disbursements were unnecessary or unreasonable, then by definition the insureds received no benefit from that work. (Petition for Review (PFR) 17.) Squire Sanders received the benefit of the money that Hartford paid for that work under the compulsion of an order requiring Hartford to pay all such bills within thirty days of presentation without any right to challenge them contemporaneously. (See 1 AA 2, 10-11; PFR 5-6.)

The argument that Squire Sanders had no direct relationship with Hartford also fails. *Buss* established that the right to reimbursement does not rest on an express contract, but rather flowed from the law's interest in rectifying unjust enrichment. (*Buss*, *supra*, 16 Cal.4th at p. 51 ["right of reimbursement . . . is implied in law as quasi-contractual, whether or not [the insurer] has one that is implied in fact in the policy as contractual"].)

Buss by its terms approved reimbursement claims against the insured, not against the insured's law firm. This result is not surprising because the issue in *Buss* was whether the insurer had the right to reimbursement for work done on uncovered claims. (See *Buss*, *supra*, 16 Cal.4th at pp. 42-43.) There was no claim that the law firm in *Buss* had engaged in unreasonable or unnecessary work, so there was no occasion to pass on the question that is presented by this case. Notably, however, this Court did not

foreclose such a claim. Quite the contrary: "Of course, the future may bring more numerous and/or more complex requests than we envision . . . . But the possible invocation of this right—or any other—is not a sufficient basis for its abrogation or disapproval." (*Id.* at p. 58.) The principles underlying restitution that *Buss* reaffirmed and applied are fully applicable here.[1]

Buss's prediction about when an insurer would pursue reimbursement—"where the defense costs the insurer may obtain in reimbursement are clear and substantial and where the assets the insured has available for reimbursement are themselves of the same sort" (*Buss, supra,* 16 Cal.4th at p. 58)—is just that: a prediction made in response to an argument that the courts would be flooded with reimbursement litigation if an insurer were not held to a sufficiently high burden of proof. (*Id.* at pp. 57-58.) As previously noted, there was no occasion for *Buss* to consider whether, or the circumstances in which, an insurer might claim reimbursement from independent counsel for unreasonable or unnecessary fees.

Squire Sanders raises a number of arguments against Hartford's position on the merits. They should not alter the outcome.

First, Squire Sanders seems to say that Hartford has no right to recover from it because Hartford had breached its contract with

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[1] The cause of action in question is not one for malpractice, but one for reimbursement, and never belonged to the insured, but was always Hartford's. Thus, cases dealing with the assignment of malpractice causes of action such as *Jackson v. Rogers & Wells* (1989) 210 Cal.App.3d 336, are inapposite.

its insureds, Squire Sanders's clients. Hartford acknowledges that there is a final order holding that it had breached its contract. (1 AA 2, 10-11.) But, of course, the absence of section 2860 rights does not mean that Hartford was left at Squire Sanders's mercy. *Buss* itself made clear that section 2860 did not affect the right to reimbursement:

> To the extent that Buss may be understood to argue that . . . the insurer's right of reimbursement is inconsistent with Civil Code section 2860 . . . he fails to persuade. Civil Code section 2860 speaks of the insurer's obligation to pay. It is altogether silent on the insured's freedom to avoid repayment.

(*Buss, supra,* 16 Cal.4th at p. 60, fn. 25.)

This argument must also be rejected even putting *Buss* aside. The very same order that required Hartford to pay Squire Sanders's bills without any deduction gave Hartford the right to seek reimbursement for unnecessary or unreasonable fees at the conclusion of the case in which Squire Sanders was the insureds' independent counsel. (1 AA 2, 10-11.) The Court of Appeal affirmed that order on appeal. (*J.R. Marketing, L.L.C. v. Hartford Cas. Ins. Co.* (Nov. 30, 2007, A115846) 2007 WL 4217443 [nonpub. opn.].) Then, in affirming the grant of Squire Sanders's demurrer to Hartford's cross-complaint—the decision before the Court on this petition—the Court of Appeal reaffirmed Hartford's right to seek reimbursement from the insureds for unreasonable or unnecessary legal fees and expenses. (See typed opn. 4, 6-7, 15.) The courts that entered and affirmed these orders obviously knew that Hartford

was in breach. Indeed, that was the entire reason for the entry of the order.

Thus, the question is not whether Hartford has a right to reimbursement notwithstanding its breach. These final orders expressly gave Hartford that right. (See also *State of California v. Pacific Indemnity Co.* (1998) 63 Cal.App.4th 1535, 1555-1556 [insurer has right to seek reimbursement if fees excessive, even if insurer in breach].) The question is against whom the right runs.

Nor is this outcome contrary to public policy. Insurers are required to construe and apply their policies to factual circumstances. They are in breach of contract if they do so incorrectly. But such a breach does not necessarily mean that they acted unreasonably or in bad faith. Indeed, the jury found against Hartford's insureds on all of their bad faith claims—a fact that Squire Sanders's answer, when describing the jury's verdict, does not mention. (Answer to Petition for Review (APFR) 8-9, fn. 3.)

Second, Squire Sanders argues that its independence would be lost if Hartford had a right of reimbursement against it. That argument fails for three reasons.

It ignores the fact that the right of reimbursement against the insureds for which the trial court and Court of Appeal orders provided, coupled with the insureds' undoubted right to seek indemnification from Squire Sanders (see, e.g., *Western Steamship Lines, Inc. v. San Pedro Peninsula Hospital* (1994) 8 Cal.4th 100, 108 [equitable indemnification available where " 'one person is unjustly enriched at the expense of another when the other discharges liability that it should be his responsibility to

pay . . . .' "]; *Schultz v. Harney* (1994) 27 Cal.App.4th 1611, 1621 [client may sue attorney for charging excessive fees]), would affect Squire Sanders's independence, if at all, the same way. The only difference is that two lawsuits instead of one would be required, to no apparent good end.

The argument also ignores the fact that Hartford could not seek reimbursement in this case until after the underlying litigation was over. Squire Sanders had already made all of its decisions about the defense of the underlying action at the time that Hartford amended its cross-complaint to assert the cross-complaint against it.

The argument, most significantly, glosses over the difference between Hartford's subjective wishes and the objective standards that both the Superior Court's affirmed order and the case law impose. Although, as a result of its breach, Hartford could not impose the hourly rate limitations of Civil Code section 2860, subdivision (c) or dispute the fees charged as they were incurred, objective criteria—whether the fees and disbursements were "unreasonable" or "unnecessary"—still govern the extent of Hartford's obligations. (See *Aerojet-General Corp. v. Transport Indemnity Co.* (1997) 17 Cal.4th 38, 62-63 [whether defense costs are reasonable is to be determined by objective standard]; see *Buss, supra*, 16 Cal.4th at p. 58 [representation by insured's independent counsel remains subject to objective legal and professional standards].)

Similarly, although Hartford could not limit the hourly rates that it was charged in this case to those "which are actually paid by

the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions" (Civ. Code, § 2860 subd. (c)), the sky did not become the limit. The rates that Hartford could legitimately have been charged were those prevailing for attorneys competent to do the work in the relevant community. (See, e.g., *Nichols v. City of Taft* (2007) 155 Cal.App.4th 1233, 1242; *MBNA America Bank, N.A. v. Gorman* (2006) 147 Cal.App.4th Supp. 1, 13.)

Third, Squire Sanders argues, somewhat inconsistently, that the insureds, not Squire Sanders, controlled the litigation. On an overall level, a client is in control. However, unsophisticated lay people who are made defendants in business litigation seeking millions of dollars are ill equipped to halt litigation procedures that a large law firm representing them has urged; and here the order requiring Hartford to pay the resulting legal bills without deduction effectively destroyed the clients' economic motivation to do so.

But this third argument raises another question: How could Squire Sanders properly represent its clients' interests and at the same time get itself dismissed from Hartford's cross-complaint, leave its clients on the hook, and try to place all the blame for its unnecessary and unreasonable fees on the clients? There are ethical problems here, but they are not of Hartford's making.

Finally, the Court of Appeal's decision suggests that allowing Hartford to seek reimbursement against Squire Sanders would reward a breaching insurer by allowing it to sue in court rather than to go to arbitration as section 2860 provides. As Hartford's petition points out, the limited relief that the Superior Court's order gave Hartford is far inferior when compared to the procedure for

resolving attorney fee disputes under section 2860. (PFR 16.) Section 2860 would have allowed Hartford a more streamlined vehicle to resolve its grievances; arbitrations would have been held as the bills were mounting to $15 million, not several years later when Hartford was already out of pocket that amount; and the rate provision of section 2860, subdivision (c) would have substantially limited the fees that Hartford had to pay in the first instance. It is for these reasons that Hartford appealed from that order and that the insureds, represented by Squire Sanders, opposed Hartford's appeal.

II. THE ISSUE PRESENTED IS AN IMPORTANT ONE.

This case presents an important question of law that merits this Court's attention. (Cal. Rules of Court, rule 8.500(b)(1).) It gives this Court an opportunity to elaborate on the law of restitution and to answer some of the questions that *Buss* left open and that, Hartford maintains, the Court of Appeal in this case got completely wrong. In addition, it allows this Court to set the ethical tone for the state, more particularly with respect to implementation of the injunction in rule 4-200(A) of the Rules of Professional Conduct against a lawyer's entering into, charging, or collecting an unconscionable or illegal fee. It would be unseemly indeed if a lawyer were able to evade that stricture just because his or her client was not paying the bill and the entity that was paying, Hartford, were precluded from pressing its enforcement.

While there is no Court of Appeal case contrary to the Court of Appeal's decision here, the statement of decision following trial of the cross-complaint, of which Hartford asked this Court to take judicial notice and to which Squire Sanders's brief refers in its opposition (APFR 15, fn. 5), held that Hartford is entitled to reimbursement of a little over $5 million and expressed its concern over the Court of Appeal's holding that the insureds, rather than Squire Sanders, had to bear the brunt of that award. (Motion for Judicial Notice 3-4.) In addition, the amicus letter for the American Insurance Association and the Complex Insurance Claims Litigation Association, the many requests, ultimately successful, to the Court of Appeal to publish its decision in this case, and at least one earlier unsuccessful claim for reimbursement from an attorney to which Squire Sanders' brief refers (APFR 13, fn. 4) indicate the importance of the issue.

The Court of Appeal's decision will change conduct going forward whenever an insurer is held to be in breach and the provisions of section 2860 are unavailable. Squire Sanders's rejoinder that it took a perfect storm, one never to recur, for this case to arise is fanciful. (See APFR 12.) Cases in which insurers are precluded from invoking section 2860 for alleged breach of the duty to defend are not rare. (E.g., *The Housing Group v. PMA Capital Ins. Co.* (2011) 193 Cal.App.4th 1150, 1158 [insurer's breach of duty to defend precluded insurer from invoking section 2860].) In such instances, the insureds will hire independent counsel at the insurer's expense and the insurer will incur legal fees unprotected by section 2860. While one hopes that independent counsel will

have a sense of propriety and restraint, it is easy to envision that some attorneys—especially if the insurer is ordered to pay their bills without deduction or timely review—will not. In those instances, not only would it be easier to recover from the lawyer than from the insured, it would also be right to do so. The Court of Appeal's decision would prevent the application of basic principles of restitution to rein in such untoward attorney conduct.

CONCLUSION

The Court of Appeal's decision makes bad law that is contrary to principles of restitution and professional responsibility of long standing in California. This Court should grant review.

August 9, 2013

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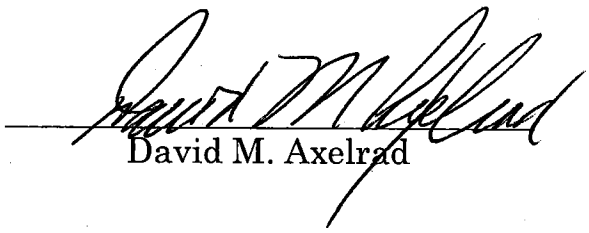
CERTIFICATE OF WORD COUNT
(Cal. Rules of Court, rule 8.504(d)(1).)

The text of this petition consists of 2,581 words as counted by the Microsoft Word version 2010 word processing program used to generate the petition.

Dated: August 9, 2013



David M. Axelrad

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

At the time of service, I was over 18 years of age and not a party to this action. I am employed in the County of Los Angeles, State of California. My business address is 15760 Ventura Boulevard, 18th Floor, Encino, California 91436-3000.

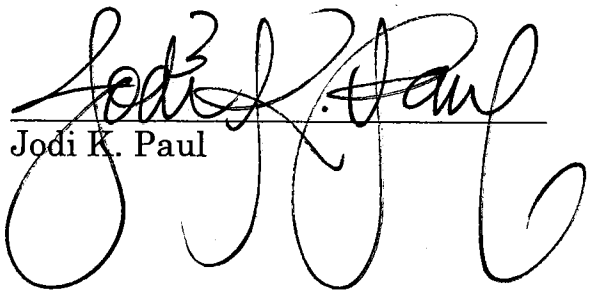
On August 9, 2013, I served true copies of the following document(s) described as **REPLY TO ANSWER TO PETITION FOR REVIEW** on the interested parties in this action as follows:

SEE ATTACHED SERVICE LIST

BY MAIL: I enclosed the document(s) in a sealed envelope or package addressed to the persons at the addresses listed in the Service List and placed the envelope for collection and mailing, following our ordinary business practices. I am readily familiar with Horvitz & Levy LLP's practice for collecting and processing correspondence for mailing. On the same day that the correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service, in a sealed envelope with postage fully prepaid.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on August 9, 2013, at Encino, California.



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